Deloitte.

CFO Insights
February 9, 2023

Globalization isn't going anywhere

Reports concerning the death of globalization are greatly exaggerated, to borrow a turn of phrase from Mark Twain. Despite a litany of dramatic disruptions—including a global pandemic, trade friction, and the Russia-Ukraine conflict—a close examination of available data does not support the notion that companies are beating a hasty retreat from global trade.

The case for deglobalization typically rests on an argument that combines evidence of political fracturing—the rise of isolationism and growing appeal of populism—with other potential signs of rupturing, such as the fragility of overstretched supply chains. In the US, signs of that fracture ranged from its withdrawal from the Trans-Pacific Partnership in 2017[1] to the imposition of tariffs on China.[2] Since The Great Recession of 2008, the argument goes, the growth of globalization has slackened to what *The Economist* has dubbed slowbalization.[3] That deceleration is expected to reverse the benefits of globalization, which included lifting more than 1 billion people out of extreme poverty,[4] and ushering in a period of higher inflation and lower productivity growth.

But projections of a smaller, faster, and cheaper world fading into the historical mist (as misperceptions about deglobalization multiply[5]) lack a solid factual underpinning. For example, the claim that deglobalization has already begun tends to be based on a misreading of a certain statistic: Goods trade as a share of GDP has fallen globally in nominal terms.[6]

In this edition of *CFO Insights*, we'll explain why it's not actually the case that deglobalization has already begun, what CFOs can learn from previous trade shocks, and why future supply chain changes, as well as government policies, will likely have limited effects.

The CFO Program

Look closer at the numbers

Globalization can be defined as the "growing interdependence of the world's economies, cultures, and populations, brought about by cross-border trade in goods and services, technology, and flows of investment, people, and information."[7] Deglobalization, it follows, would be the unwinding of that interdependence.

While it's true that the world trade to GDP ratio has fallen off since the Great Recession, that oft-cited fact by itself doesn't reflect an understanding of what underlies those numbers. Commodities play a much more significant role in international trade than they do in overall GDP. The commodity super-cycle—the dramatic rise and subsequent fall of commodity prices in the early 2000s—drove most,[8] if not all, of the decline in goods trade as a share of GDP.

After adjusting for inflation, goods trade as a share of global GDP has actually not declined. However, that number may have stopped rising around the time of the global financial crisis, starting in 2008. Using different measures of inflation can yield slightly different results, but the overall conclusion would be the same.

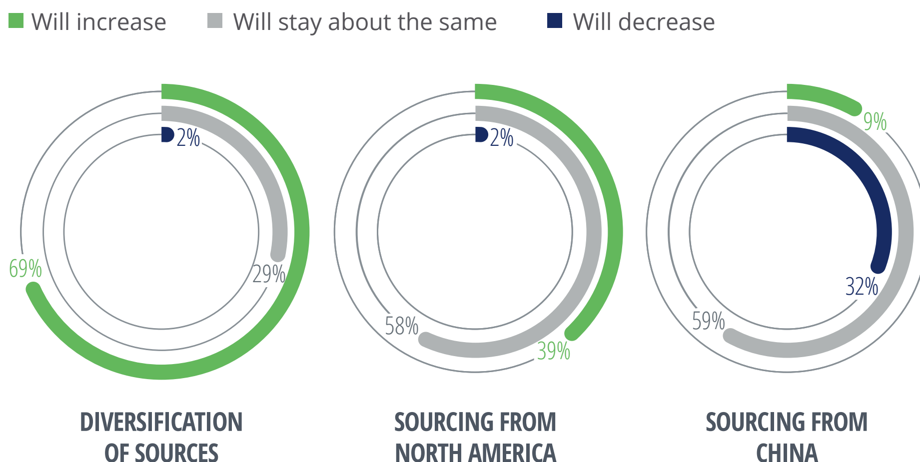
Part of the reason is that a large share of global trade is immovable: Roughly 20% of international trade consists of animals, vegetables, minerals, and fuels.[9] Unless natural resource endowments suddenly change, procuring these items from domestic, or even third-party, sources will be difficult. Producing goods near the source of their raw materials to minimize transportation costs would likely prevent more trade from being relocated. Other parts of the supply chain are highly capital-intensive and require huge sums of investment, making them difficult to abandon even under the most extreme circumstances.

Chain reaction

The COVID-19 pandemic revealed what can happen when global supply chains weaken. For CFOs, the consequences included dropping sales, rising manufacturing costs, and dissatisfied customers whose demand could not be met, at least on the desired timetable.

In Deloitte LLP's 3Q 2021 North American *CFO Signals™* survey, 44% of responding CFOs reported that supply chain shortages or delays had increased their company's costs, while 28% expected future sales to suffer as a result. More than two-thirds of CFOs (69%) indicated that they expected to increase the diversification of their supply chain within three years. In terms of specific regions, 39% said that they expected supply chain sourcing from North America to increase, while nearly one-third indicated that their sourcing from China would decrease (see Figure 1).

Figure 1. How CFOs expect their supply chains to change by 2024



Source: *Deloitte CFO Signals (Q3 2021)*

Lessons from shocks to global supply chains

Examining two recent shocks to global supply chains can help us better understand whether we are on the precipice of deglobalization.

The first shock is the US-China trade war, where both countries raised substantial tariffs on each other's goods. The US import side of the conflict, which is much larger in value terms, shows that the trade war shock did not result in deglobalization. Although the share of US imports from China declined by 3.8 percentage points since the start of the trade war in 2018,[10] that production did not return back to the United States. Indeed, real US imports as a share of real US GDP continued to climb since the US-China trade war began,[11] suggesting that the United States became less self-sufficient. A more detailed analysis shows imports from other countries mostly replaced the drop in US imports from China.[12]

The second shock worth studying is the 2011 disaster at Fukushima, the nuclear power plant. When Japan was struck by an earthquake in 2011 and then by a powerful tsunami, supply chains in and out of Japan broke down. Economists from the World Bank found little evidence that reshoring occurred; for some manufacturing goods, internationalization actually intensified.[13]

The World Bank also found that companies with limited exposure to Japan did not adjust their supply chains, while companies with larger exposures typically moved some of their production to a third country. This finding fits neatly with economic models of supply chains, which show that the cost of keeping production in a high-risk country rises with the value of what it produces. For example, a company buying insurance to mitigate natural-disaster risk would see its insurance premiums rise with the value of the goods being insured. Therefore, companies with small exposures to a particular risk may find that the sizable upfront costs of switching the supply chain—which can include building a new factory and establishing new relationships—outweigh the benefits of moving to a new country, even when such a move includes a reduction in insurance premiums.

On location

Some analysts have hypothesized that recent supply chain shocks will likely result in nearshoring.[14] The rationale is that disruption risks rise with the length of the supply chain. However, little evidence indicates that this has occurred after previous trade shocks.

In the World Bank study of international trade after the Fukushima disaster, rerouted suppliers typically remained far from the importing country. For some goods, especially computer components, the supply chain lengthened. The one exception was finished autos, which typically moved to a closer country because of their high transportation costs.[15] However, much of that may be explained by the growing consumer market in China and other developing nations that required production to be more regionalized to support profitable growth in these markets.

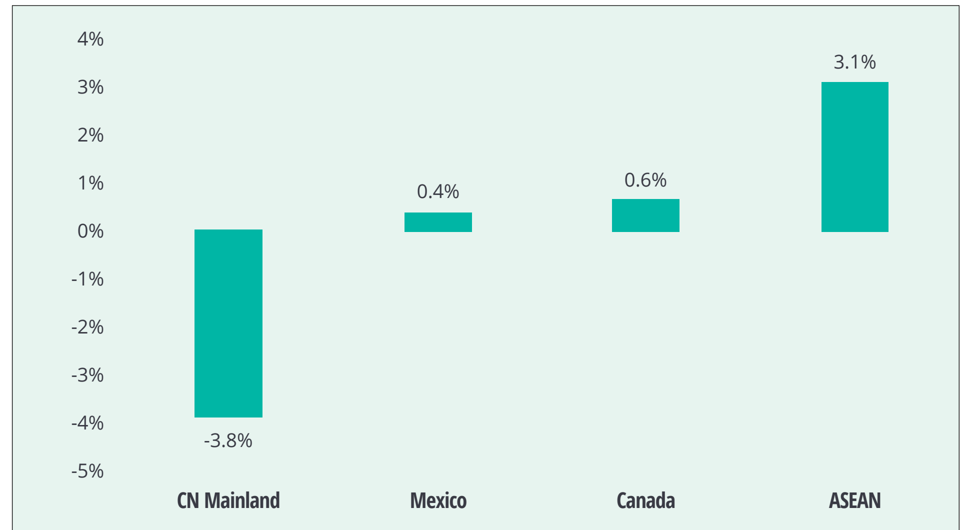
A similar finding turns up when examining the US-China trade war. While the share of imports from China fell after the trade war began in 2018, the share of imports from Mexico and Canada grew only modestly. Instead, the share of imports coming from ASEAN countries climbed 3.1%, accounting for nearly 80% of the share China lost[16] (see Figure 2). Many have referred to this shift as the "China + 1" diversification strategy. Plus, nearshoring supply chains does not necessarily reduce the risk of disruption. The Russia-Ukraine conflict highlights the risks of Western European importers sourcing solely from Eastern Europe. [Climate change and natural disasters] are already affecting large parts of the world and will likely continue to do so, suggesting that concentrating production in one geography, even if close to final consumers, remains a risky proposition.

United nations

Historical evidence from the Fukushima disaster and the US-China trade war suggests that deglobalization has not begun and is not triggered by large disruptions to trade. However, that does not mean globalization will evolve as it did in the past. For finance leaders, strategic decision-making may focus less on "just in time" than on "just in case."

Figure 2. Share of imports into the United States since the start of the US-China trade war

Share of US imports (percentage point change from October 2017 to October 2022, 12- month moving average)



Source: US Census Bureau; author calculations.

And how globalization ultimately evolves will likely determine the implications for the macroeconomic environment. Proponents of deglobalization have said that the world will face higher inflation[17] and lower productivity growth as a result. Such an argument suggests that the high cost of moving supply chains comes at the expense of deploying capital to more productive investments. Plus, a country’s comparative advantages will likely be overshadowed by its exposure to risks. This could raise inflation, lift interest rates, crowd out investment, and lower productivity growth. However, there are reasons to be optimistic that future changes to supply chains will not result in such a scenario.

The evolution of supply chains will depend on the risks at hand, the relative costs of mitigating those risks, and government policies worldwide. Given that risks in the current environment, which include climate change, geopolitical tensions, and a lingering pandemic, affect numerous geographies simultaneously, adding some redundancy to the supply chain is likely the best way to minimize those risks. Instead of scrapping production in a higher-risk area and losing out on the substantial investment that it had required, additional production will likely be added in a lower-risk area as more capacity is needed.

Even so, it seems safe to say that international trade—where raw materials can be extracted in central Asia, components manufactured in Taiwan, and assembly shifted to east Asia, with final sales set for Europe or elsewhere—is staying put. This doesn’t mean that companies should necessarily leave their globalization plans intact and conduct business as usual. Instead, it would be wise to revisit plans for both opportunities and constraints, along with the myriad risks, and be ready to pivot as needed. For example, Deloitte LLP’s 4Q22 North America *CFO Signals* survey found that 53% of CFOs plan to expand their products and services inside North America, while 33% plan to do so in other regions.[18] Options may not be limitless, but it’s still a big world out there.

A new globalization calculus

Critical questions for investing in resilience

Global trade dates back to the Roman Empire, when China’s Silk Road served as a trade route between China and the West. Since the 1980s, globalization has reached an unprecedented scale, partly due to the dismantling of trade barriers, geopolitical events, and technological advances.

But altered by the COVID-19 pandemic, as well as other challenges, the nature of globalization has caused many CFOs and other leaders to rethink their strategies and decision-making. Instead of basing decisions primarily on costs, efficiency and speed, executives now have to consider risk and resilience more. Years of focusing on “just-in-time” delivery may be shifting to focus on “just-in-case” preparedness. Companies may want to consider the following seven questions as they revisit their global footprint.

1. **Are your supply sources for critical materials and production, as well as inventories, concentrated in one or two areas, or should you diversify further to protect assets and reduce vulnerabilities?**
2. **Does your company have sufficient cash or lines of credit to weather geopolitical shocks, especially if access to capital grows tight?**
3. **Do you have clear visibility into the risks that exist in your suppliers, particularly Tier 1, and how well are you protected from disruptions?**
4. **Has your company made necessary investments in digitization, which can increase visibility into the supply chain and other issues and provide the data to address them? And do you have the talent to generate insights from that data?**
5. **How quickly can your company identify and activate alternate supply sources, and what are the cost trade-offs in terms of capital, lost opportunities, customer loyalty, and brand reputation?**
6. **Given bad actors’ growing sophistication and activities, how well-equipped is your company to manage increased cyber risk?**
7. **When your company invests in global trade, are you doing so in a way that provides both cost and tax efficiencies and considers credits and incentives, as well as evaluating customs costs?**

As geopolitical events and other disruptions prompt more vacillations in the globalization trajectory and introduce more challenges to strategic decision-making, investing the effort into creating redundancies and increasing visibility could be time well spent. Reshaping supply chains may take time, but in the end the effort will help enable companies to respond faster and more efficiently to global events that could threaten the business.

End notes

1. "The United States Officially Withdraws from the Trans-Pacific Partnership," Office of the U.S. Trade Representative, January 1, 2017.
2. "Trump Hits China With Tariffs on $200 Billion in Goods, Escalating Trade War," *The New York Times,* Sept. 17, 2018.
3. "The steam has gone out of globalisation," *The Economist,* Jan. 24, 2019.
4. "Globalization's Greatest Triumph: The Death of Extreme Poverty," Cato Institute, September 26, 2018.
5. "The pandemic adds momentum to the deglobalization trend," Peterson Institute for International Economics, April 23, 2020.
6. Ibid.
7. "What is globalization?," Peterson Institute for International Economics, October 29, 2018.
8. "The peak globalization myth: Part 2—Why the goods trade ratio declined," VoxEU, September 1, 2022.
9. "*Product imports, by country and region in US$ thousand 2019*," World Integrated Trade Solution, accessed December 2, 2022.
10. Authors' calculations using US Census Bureau data.
11. Authors' calculations using data from Oxford Economics.
12. "Four years into the trade war, are the US and China decoupling?," Peterson Institute for International Economics, October 20, 2022.
13. "*Natural disasters and the reshaping of global value chains*," World Bank Group, June 2021.
14. "What can we learn about reshoring after COVID-19," *Operations Management Research,* August 2020.
15. Ibid.
16. Author calculations based on Census Bureau data.
17. "Why deglobalization makes US inflation worse," Project Syndicate, October 7, 2022.
18. CFO Signals™ 4Q 2022, US CFO Program, Deloitte LLP.

Contacts

Ira Kalish
Chief Global Economist
Deloitte Global
ikalish@deloitte.com

Jim Kilpatrick
Global Supply Chain & Network Operations leader
Canadian Consumer Products Industry leader
Deloitte Canada
jimkilpatrick@deloitte.ca

Michael Wolf
Global economist
Senior manager
Deloitte Global
miwolf@deloitte.com

About Deloitte's CFO Program
The CFO Program brings together a multidisciplinary team of Deloitte leaders and subject-matter specialists to help CFOs stay ahead in the face of growing challenges and demands. The program harnesses our organization's broad capabilities to deliver forward thinking and fresh insights for every stage of a CFO's career—helping CFOs manage the complexities of their roles, tackle their company's most compelling challenges, and adapt to strategic shifts in the market.

For more information about Deloitte's CFO program visit our website at:
www.deloitte.com/us/thecfoprogram.

Follow us @deloittecfo

Deloitte CFO Insights are developed with the guidance of Dr. Ajit Kambil, Research Director, CFO Program, Deloitte LLP; and Josh Hyatt, Manager/CE Journalist, CFO Program, Deloitte LLP.

This publication contains general information only and Deloitte is not, by means of this publication, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This publication is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor.

Deloitte shall not be responsible for any loss sustained by any person who relies on this publication.

About Deloitte
Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as "Deloitte Global") does not provide services to clients. In the United States, Deloitte refers to one or more of the US member firms of DTTL, their related entities that operate using the "Deloitte" name in the United States and their respective affiliates. Certain services may not be available to attest clients under the rules and regulations of public accounting. Please see www.deloitte.com/about to learn more about our global network of member firms.

Copyright © 2023 Deloitte Development LLC. All rights reserved.